

# **AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON ENGCOCO MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Engcoco Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, the statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information and the accounting officers report, as set out on pages ... to ....

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act of South Africa (Act no. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of South Africa, section 4 of the Public Audit Act of South Africa and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Property, plant and equipment**

4. The transitional provisions of Directive 4 require the disclosure of all asset additions since the effective date of 1 July 2008. Asset additions to the value of R12,7 million (2009: R8,5 million) have not been disclosed in the financial statements of the municipality. I was unable to verify the completeness and existence of the asset additions for these years. The municipality's records did not permit the application of alternative audit procedures regarding the completeness of additions.
5. The fixed asset register maintained by the municipality revealed numerous discrepancies, which include duplication of assets and asset numbers, as well as assets not included in the asset register. The municipality's records did not permit the application of alternative procedures; consequently, I was unable to obtain appropriate audit assurance of the completeness of the fixed asset register.

### **Value-added tax (VAT) receivable**

6. The municipality is registered for the payment of VAT on the invoice basis at the time of supply. However, in contravention of section 15 of the VAT Act, 1991 (Act No. 89 of 1991), the municipality recorded transactions on the cash basis and therefore VAT was accounted for, and claimed and paid on the same basis.
7. A reconciliation of the net VAT receivable between the statement of financial position of R2,6 (2009: R3,1) million and the balance due per the South African Revenue Service of R4,4 million revealed a difference of R1,8 million. Consequently, I was not able to verify the completeness, existence and valuation of the VAT receivable and I could not determine the effect on other account balances or classes of transactions contained in the financial statements.
8. Input VAT totalling R10,4 million was not claimed by the municipality during the year. This has resulted in an overstatement of infrastructure assets by R1,4 million and general expenditure by R9 million. Therefore, I was unable to satisfy myself as to the completeness, existence and valuation of the VAT receivable.

### **Trade and other receivables from non-exchange transactions**

9. Included in other receivables in note 3 to the financial statements is an amount of R2,7 (2009: R2,0) million relating to the water services agency agreement with the Chris Hani District Municipality. The municipality could not provide appropriate supporting documentation to support this receivable. This is as a result of the municipality not reconciling its balance with that of the Chris Hani District Municipality on a monthly basis. Even after performing alternative procedures I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, existence and valuation of the Chris Hani District Municipality receivable.

### **Trade and other payables from exchange transactions**

10. The municipality could not provide documentation in support of the balance of R2,9 million which is included in other creditors in note 6 to the financial statements. Included in the amount are credit transactions of R827 899 and debit transactions of R813 524 for which appropriate audit evidence, to verify the completeness, existence, valuation and allocation of the balance, could not be obtained. In addition, conditional grant revenue and expenses recognised in the account have not been recorded as such in the statement of financial performance. The municipality's systems and records did not permit the application of alternative procedures relating to other creditors.
11. The municipality did not maintain adequate systems to monitor the capturing of leave days taken by employees and the rates used to calculate the leave accrual. I could therefore not determine the completeness, existence and valuation of the leave accrual amount of R1,9 million as disclosed in note 6 to the financial statements. The municipality's records did not permit the application of alternative audit procedures regarding the completeness, existence and valuation of the leave pay accrual balance.
12. I was not able to confirm whether the corresponding amount for trade and other payables of R2,1 million was adjusted to correct and attend to limitations that caused me not to express an opinion on the financial statements for the year ended 30 June 2009.

### **Employee costs**

13. The municipality could not provide complete employee files and other appropriate documentation in support of basic salaries, compensative/circumstantial payments, overtime, leave, periodic payments and other non-pensionable allowances. This is as a result of poor record keeping and document management. As a result, I was unable to obtain sufficient appropriate evidence relating to the occurrence and accuracy of employee costs of R18,4 (2009: R15,3) million included in the statement of financial performance and in note 18 to the financial statements. The municipality's records did not permit the application of alternative audit procedures regarding the completeness and accuracy of employee costs.

### **General expenses**

14. The municipality could not provide sufficient appropriate audit evidence to support general expenditure of R2,2 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all goods and services were properly recorded. Consequently I could not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of goods and services of R87,7 (2009 :R16,3) million as disclosed in the statement of financial performance and in note 21 to the financial statements.

### **Cash and cash equivalents**

15. The municipality could not provide sufficient appropriate audit evidence for the difference between the balance of the main bank account per the general ledger and the balance as per the bank confirmation received. An unknown difference of R367 541 exists between the two balances. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance as to the reasons for this difference. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of cash and cash equivalents amounting to R13,4 (2009: R9,2) million in the statement of financial position.

### **Irregular Expenditure**

16. Section 112(1) of the MFMA requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Payments amounting to R12,8 million, identified during the audit and subsequently disclosed in note 27.3 to the financial statements, were made in contravention of the supply chain management requirements. As a result of management not implementing a system to identify and disclose irregular expenditure an additional R3 million of irregular expenditure has been identified. However, completeness of this amount could not be determined.

### **Accumulated surplus**

17. I was not able to confirm whether the comparative amount that related to accumulated surplus of R1,5 million was adjusted to correct and attend to limitations that caused me to not express an opinion on the financial statements for the year ended 30 June 2009. Where misstatements from the prior year were corrected I have obtained appropriate audit evidence regarding the corrections made.

### **Disclaimer of opinion**

Because of the significance of the matters described in the basis for disclaimer opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

### **Emphasis of matter**

I draw attention to the matters below. My opinion is not modified in respect of these matters:

### **Restatement of corresponding figures**

18. As disclosed in note 25 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of the adoption of the transitional provisions provided for in Directive 4 regarding the balances of property, plant and equipment.

19. As disclosed in note 26 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of prior period errors identified.

### **Unauthorised expenditure**

20. As disclosed in note 27.1 to the financial statements, unauthorised expenditure amounting to R2,5 million has been incurred due to the overspending of budget.

### **Irregular expenditure**

21. As disclosed in note 27.3 to the financial statements, the following irregular expenditure has been disclosed:

- R11,5 million incurred due to improper implementation of supply chain regulations.
- R1,1 million incurred, due to councillors' remuneration not being within the approved upper limits of Circular 55/2009
- R141 196 incurred due to non-compliance with employee-related costs.

### **Additional matters**

I draw attention to the matter below. My opinion is not modified in respect of this matter:

## **Unaudited supplementary schedules**

22. The supplementary annexures set out on pages ... to ... do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

In terms of the PAA of South Africa and *General notice 1570 of 2009*, issued in *Government Gazette No. 32758 of 27 November 2009* I include below my findings on the report on predetermined objectives, compliance with section 45 of the Municipal Systems Act of South Africa, 2000 (Act No.32 of 2000) (MSA) and financial management (internal control).

### **Predetermined objectives**

23. Material findings on the report on predetermined objectives, as set out on pages ... to ... are reported below;

### **Non-compliance with regulatory and reporting requirements**

#### **Content of the integrated development plan**

24. The integrated development plan of the municipality did not include the financial strategy for achieving objectives including a plan for sourcing funding and methods of financing the various objectives and targets, as required by section 26(h) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

25. The organogram included in the integrated development plan (IDP) of the municipality does not:

- identify personnel responsible for the implementation of the IDP
- address the municipality's transformation needs as required by Regulation 2 (1) (a) of the Municipal Planning and Performance Management Regulations 2001 (MPPMR).

#### **Lack of adoption or Implementation of a performance management system**

26. The municipality did not provide me with its adopted framework that describes how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the MPPMR.

## **Usefulness of information**

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

27. The municipality has not reported throughout on its performance with regard to its targets as per the approved IDP. There are 142 targets per the report, which do not reconcile with the 37 targets per the IDP. Therefore consistency of reported information could not be determined.
28. The performance indicators and performance targets were evaluated against the criteria per the National Treasury Framework for Managing Programme Performance Information and the following deficiencies were identified:
- The report on predetermined objectives only contains a summary of the key performance indicators per the IDP.
  - The report on predetermined objectives does not provide details on which key performance indicators were met.

## **Reliability of information**

The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity, i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit findings relate to the above criteria:

29. The targets achieved per the report do not reconcile to the actual targets achieved.

- The completion certificates for the Mpindweni Access Road, Ndlunkulu Access Road, Qenqeleka Access Road and Qoba Access Road were not completed by the contractors. The date on the completion certificate for Mpindweni Roads could not be agreed to the dated approved by the technical manager.

30. The annual performance plan did not include a comparison with the prior period's performance. No measures to improve performance were disclosed.

## **COMPLIANCE WITH LAWS AND REGULATIONS**

### **Municipal Finance Management Act of South Africa**

#### **Expenditure was not paid within the parameters set by the applicable legislation**

31. The municipality did not make all payments due to creditors within 30 days as required by section 65(2)(e) of the MFMA.

#### **Expenditure was incurred not in accordance with approved legislation. .**

32. Expenditure incurred not in accordance with sections 15 and 11(3) of the MFMA resulted in unauthorised expenditure.

#### **Expenditure incurred on capital projects has not been approved by the council**

33. In terms of section 19(1)(b) of the MFMA the municipality may spend money on a capital project only if the project, including the total cost, has been approved by the council.

#### **The accounting officer did not adhere to his statutory responsibilities**

34. The municipality did not submit all information, returns, documents, explanations and motivations prescribed or required by the National Treasury, in terms of section 74(1) of the MFMA.

35. Evidence could not be obtained that the accounting officer submitted a consolidated report of withdrawals to the council, the provincial treasury or the Auditor-General in terms of section 11(4) of the MFMA.

36. Budgetary approval, implementation, adjustments, monitoring, and submission of budgets to relevant authorities in the prescribed budget format have not been adhered to in terms of sections 22, 24(2) (c), 28(1-5), 69(1), 71(1-5) of the MFMA.

37. The accounting officer did not take reasonable steps to ensure that the resources of the municipality are used effectively, efficiently and economically and that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards in terms of section 62(1) (a) and 62 (1) (b) of the MFMA.

38. The accounting officer did not take all reasonable steps to ensure that internal audit has been operating in accordance with any prescribed norms and standards as required by section 62(1)(c)(ii) of the MFMA.

39. The accounting officer has not maintained an adequate system of internal control over assets and liabilities as required by section 63(2) of the MFMA.

**The audit committee was not functioning properly**

40. The audit committee did not dispense with all its duties as required by section 166(1) and (2)(a) of the MFMA.

**The internal audit unit was not functioning properly**

41. Internal audit did not dispense with all its duties as required by section 165(2) of the MFMA.

**The financial statements were not prepared in accordance with applicable legislation**

42. The municipality did not maintain effective, efficient and transparent systems of internal control as required by section 62(1)(c), 78(1)(a), 63(2)(c), 64(2)(f), 65(2)(c), 67(1)(b), 95(c)(i), 105 (1)(a), 96(2)(b), 97(i), 99(2)(d) over:

- assets and liabilities
- debtors and revenue
- creditors and payments
- guarding against fraud, theft and financial mismanagement.

43. The municipality did not prepare financial statements that fairly present the state of affairs of the municipality as required by section 122(1) (a) of the MFMA. Material misstatements were identified during the audit; some of which have been corrected. The remaining material misstatements are included in the basis for disclaimer paragraphs.

44. Section 125(2)(d)(i) of the MFMA has not been complied with regarding disclosing any material losses and any material irregular or fruitless and wasteful expenditures, including in the case of a municipality, any material unauthorised expenditure, that occurred during the financial year, and whether these are recoverable.

**Municipal Systems Act**

45. The municipality has not developed and adopted policies, plans, strategies and programmes, including setting targets for delivery in terms of section 11(3)(a) of the MSA.

46. The council's decisions to comply with the majority vote rule has not been exercised in terms of section 160 of the MSA regarding council.

47. Adequate system of internal controls has not been implemented to ensure that the debt and credit policy of the municipality is effectively enforced as required by section 100 of the MSA.



48. The roles and responsibilities of senior management have not been adequately documented as required by section 53 of the MSA.

### **Compliance with other enabling legislation**

#### **Environmental Conservation Act**

49. Section 20(1)(a) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989) states that "No person shall establish, provide or operate any disposal site without a permit issued by the Minister of Water Affairs and that the Minister may issue a permit subject to such conditions as he may deem fit". The municipality is in possession of an expired landfill permit.

### **INTERNAL CONTROL**

50. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA), but not for the purposes of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraph, the findings on the report on the report on predetermined objectives and the findings on compliance with laws and regulations.

#### **Leadership**

51. Management's philosophy was positive, but oversight responsibilities over reporting, compliance with laws and regulations and internal control were not exercised. The fact that various officers acted in the accounting officer's position resulted in a failure in the process to evaluate whether management has implemented effective internal controls. Municipal officials do not monitor tasks delegated to subordinates and excessive reliance is placed on certain staff.
52. Monthly management information is not reliable and useful as a result of management not fulfilling their responsibilities and accepting accountability for their areas of responsibility. Certain senior officials also do not have performance contracts in place.
53. Delegations of responsibility are not adequately in place, as set out in section 106 of the MFMA.

#### **Financial and performance management**

54. The municipality was unable to provide the auditor with adequate supporting documentation for various components of the audit. This is as a result of the municipality not having an adequate record management system in place to ensure easy retrieval of documents.
55. The municipality's manual and automated controls are not designed and controls are not implemented to ensure that the transactions have occurred, are authorised and are completely and accurately processed. Management does not adequately monitor transactions upon recording. The control systems also do not respond adequately to the risks of fraud in payroll, procurement and the payment for expenditure.

56. The municipality does not have adequate controls in place to identify and record irregular and fruitless and wasteful expenditure.

## **Governance**

57. The internal audit division was not effective in performing its duties and responsibilities as it was understaffed. The internal audit unit of the municipality did not have policies and procedures in place to ensure that the audit approach and methodology comply with the necessary standards. No disclosure of non-compliance with Standards for the Professional Practice of Internal Auditing (standards) as prescribed by the Institute of Internal Auditors was made. Internal audit reports detailing the internal audit performance against annual plans were not prepared and submitted to the audit committee. No follow-up audits were conducted to confirm that management actions were taken with regard to recommendations made by internal audit and no alternative procedures were undertaken to ensure that management implemented internal audit recommendations. Procedures are not in place to ensure that the audit reports are distributed to the audit committee, accounting officer and to those who will be responsible for the implementation thereof. These limitations affected the adequate discharge of the audit committee's duties during the year under review. Sufficient time was not spent engaging the municipality regarding internal controls and risk management and this was evident by the number of cancelled audit committee meetings.

58. The audit committee did not exercise sufficient oversight over the implementation of the internal audit function. This contributed to the findings mentioned in the preceding paragraphs.

## **OTHER REPORTS**

### **Investigations in progress**

59. The special investigating unit is currently investigating the validity of learner and driver licences issued for the 2006, 2007, 2008, 2009 and 2010 financial years at the request of the Department of Transport. The outcome of this investigation has not yet been concluded.

*Auditor-General*

East London

30 November 2010



AUDITOR-GENERAL  
SOUTH AFRICA

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